

TESTIMONY OF

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**BEFORE THE COMMITTEE ON
COMMERCE, SCIENCE AND TRANSPORTATION
UNITED STATES SENATE**

**REGARDING STATE EXPENDITURES
UNDER THE MASTER SETTLEMENT AGREEMENT**

October 5, 2000

Mr. Chairman and Distinguished Members of the Committee:

My name is John Hurson. I am the Majority Leader in the House of Delegates of the Maryland General Assembly. I am speaking on behalf of the National Conference of State Legislatures where I serve as the chairman of the Assembly on Federal Issues, the policymaking arm of the conference.

It is a pleasure for me to be here as part of such a distinguished panel to discuss how the states have responded to the tobacco settlement. I would like to take this opportunity to thank Surgeon General Satcher and the Centers for Disease Control and Prevention (CDC) for the extraordinary assistance they have provided to states. The CDC staff have provided technical assistance to many legislatures and their materials “best practices” are widely used as models. My own state is working in partnership with the CDC to move forward on our tobacco initiative.

I would also like to acknowledge the work of the American Cancer Society and Tobacco Free Kids. In Maryland we are working hand-in-hand with the advocacy community to try to make our initiative as strong as it can be. That being said, I know that I and my colleagues in legislatures in Maryland and across the nation are not always as receptive to my fellow panelists’ recommendations as they might like. However, I urge them to continue participating in the process and to

spend even more time in the nation's state capitols working on these important issues.

MASTER SETTLEMENT AGREEMENT

Overview

On November 23, 1998 the Attorneys General of 46 states, Puerto Rico, the U.S. Virgin Islands, American Samoa, the Northern Mariana Islands, Guam and the District of Columbia signed an agreement with the five largest tobacco manufacturers, ending a four-year legal battle between the states and the industry that began in 1994 when Mississippi became the first state to file suit. Four states (Florida, Minnesota, Mississippi and Texas) had previously settled with tobacco manufacturers for \$40 billion. This Master Settlement Agreement (MSA) settled all antitrust, consumer protection, common law negligence, statutory, common law and equitable claims for monetary, restitutionary, equitable and injunctive relief alleged by any of the settling states with respect to the year of payment or earlier years. The MSA cannot be modified in any way unless all the parties agree to the modification.

The Master Settlement Agreement did not include specific provisions for tobacco growers and impacted communities, but did call for participating manufacturers, tobacco growers and state officials from tobacco producing states to continue a dialogue. The National Tobacco Growers Settlement Trust was agreed to on July 19, 1999. In the agreement, the 14 tobacco producing states (North Carolina, Kentucky,

Tennessee, South Carolina, Virginia, Georgia, Ohio, Indiana, Florida, Missouri, West Virginia, Alabama, Maryland, and Pennsylvania) agreed on a formula for the distribution of a \$5.15 billion trust fund. Under the agreement, the funds would be distributed to the states using the quota system used by the U.S. Department of Agriculture (USDA).

WHAT HAVE STATES BEEN DOING SINCE THE ADOPTION OF THE MSA?

Under the provisions of the agreement, states were required to begin implementation of the settlement agreement immediately. States that had suits pending were required to begin actions to settle the suits and to get the consent decree implementing the settlement agreement filed by December 11, 1998. The other states were required to file the necessary paperwork by December 23, 1998. This began the process of obtaining state specific finality, the trigger for access to the funds. State courts reviewed the consent decrees and addressed challenges to the implementation of the settlement agreement in the states. States have until December 31, 2001 to obtain state specific finality. Failure to achieve state specific finality by the deadline would effectively remove the state from the MSA. Currently, all but two states (Arkansas and Missouri) have achieved state specific finality.

The most immediate task for state legislatures was: (1) to resolve the Medicaid recoupment conflict with the Administration and Congress;

and (2) to consider and enact the "model statute"¹ included in the settlement agreement. This model statute is designed to provide a level playing field between participating and non-participating tobacco manufacturers. Failure to enact the model statute could result in a significant reduction in a state's allotment by triggering the nonparticipating manufacturers adjustment. I am pleased to say that the Medicaid recoupment issues was successfully resolved in the spring of 1999. I am also pleased to report that the Model Statute has now been enacted by all of the states included in the Master Settlement Agreement.

Managing the Tobacco Settlement Funds

The next task for states was to determine how the state would structure the settlement funds. Should a trust fund or endowment be established? Should the state consider bond securitization? Should the funds just go into the general fund and be appropriated under the regular process?

According to our most recent information, 26 states have created trust funds and four states have established endowments. Trust funds are

¹ Under the MSA, if in any year the total aggregate market share of the participating manufacturers decreases more than 2 percent and an economic consulting firm determines that the provisions of the MSA were a significant factor contributing to the market share loss, payments to states may be reduced based on that loss. This reduction in state payments is called the non-participating manufacturers (NPM) adjustment. This analysis is done annually. A state's enactment of the model statute is significant because **if there is an NPM adjustment in any year, a state's payment will not be reduced at all if that state has passed and has in force the model statute.** Payments to the states that do not have a model statute or qualifying statute in full force and effect will be reduced to cover the entire NPM adjustment. This could result in a state losing its entire payment for that year. If a state enacted the model statute, but the statute is overturned or invalidated by a court action, the state would pay no more than 65 percent of its payment toward the NPM adjustment in that year. If a state has enacted a "qualifying statute" as opposed to the model act in the MSA, and the qualifying statute is struck down by a court, the state will not enjoy any of the protections afforded states that enact the model act. In other words, those states would be subject to the full NPM adjustment in that year and would not enjoy the benefits of the 65 percent cap.

usually subject to the appropriations process and the principal is available for expenditure. The fund is usually maintained as separate accounts in the state treasury. Five states (Idaho, Kansas, Louisiana, Minnesota, Mississippi, and New Mexico) have established endowments. Utah will establish an endowment if a proposed ballot initiative is adopted by the people in November. Most endowments limit expenditures to income generated from investments. The principal is never spent. The other states are generally appropriating the funds from the general fund, but are establishing spending guidelines through legislation.

Finally, some states are considering bond securitization, which permits a state to receive a discounted lump sum payment up front. South Carolina enacted legislation to securitize its tobacco payments beginning in 2001, shielding the state from inherent instability in the tobacco settlement funding structure (pending state and federal lawsuits, volume reductions etc.). Florida and Iowa enacted legislation authorizing securitization, but additional legislation would be necessary to move forward. Three jurisdictions in New York (Westchester and Nassau counties and New York City) have securitized the funds they received from the state settlement. Arkansas would authorize the issuance of revenue bonds if the tobacco settlement ballot initiative is adopted by the voters.

Developing Spending Plans for the Tobacco Settlement Funds

I would like to submit the report, *State Allocation of Tobacco Settlement funds: FY 2000 and 2001*, published August 1, 2000 by the Health Policy Tracking Service at NCSL, in its entirety for the record. I will briefly summarize the highlights of the report here.

Approximately, 43 percent of the appropriated funds are dedicated to health care, 9 percent is set aside for tobacco prevention and cessation; 3 percent for long term care; 2.5 percent for research and 6.5 percent for services for children and adolescents. The remaining funds are used for education (5.9%); tobacco growers (6%); budget reserve (6%) and miscellaneous other spending (17%).

My colleagues across the country are working very hard to be responsive to the citizens of their respective states and have made extraordinary efforts to obtain input from the people in their states regarding the disposition of these funds. As you know, if we as elected officials fail to see the signal or heed the call, the voters have a way of letting us know exactly how they feel. I am confident that the decisions of my colleagues in legislatures east, west, north and south and all places in between are enjoying a very high level of support from the citizens in their states.

While I am only aware of two states (Indiana and Illinois) that have current plans to fully implement the Centers for Disease Control and Prevention's (CDC's) best practices guidelines for tobacco cessation and prevention activities, I know that many states are using these guidelines as a model and to set goals. I urge this committee to continue to support the CDC in these outreach and technical assistance activities.

Implementing the Tobacco Settlement in Maryland

Maryland is moving quickly to implement the provisions of the Maryland Cigarette Restitution Program (CRF). We are working closely with health advocates, our local health departments and academic health centers to make this a successful initiative. It is a two-pronged approach focusing on: (1) Tobacco Prevention and Cessation; and (2) Cancer Reduction.

The Tobacco Prevention and Cessation Program is a \$18.1 million program that provides \$2.3 million for statewide public health activities; \$7 million for local public health activities (administered primarily by county government); \$5 million for countermarketing; \$3 million for surveillance and evaluation; and \$800,000 for program administration.

The \$30.8 million Cancer Reduction initiative includes \$15 million for academic health centers; \$12.8 million for local public health activities; \$2.3 million for surveillance and evaluation; and \$800,000 for program administration.

November 2000 Ballot Initiatives

Last year Louisiana adopted a constitutional amendment, through a ballot initiative, establishing the Millennium Trust and the Louisiana Fund within the state treasury. These Millennium Trust supports education and academic health center programs. The Louisiana Fund

provides funds for Medicaid, attorney general enforcement activities related to the tobacco settlement, smoking prevention and cessation programs and other health-related activities. This year six states (Arkansas, Arizona, Montana, Oklahoma, Oregon and Utah) will take the tobacco settlement expenditure question directly to the voters via ballot initiative.

- Arkansas – a comprehensive tobacco settlement expenditure plan that includes funds for tobacco prevention and cessation, education, and research.**
- Arizona – two separate ballot initiatives, both would provide funds for health care for low-income adults and children. One of the initiatives replaces tobacco tax funding with tobacco settlement funding for some health programs.**
- Montana – establishes a trust fund, comprised of 40% of the tobacco settlement, the proceeds of which can be used for tobacco disease prevention programs and state programs providing benefits, services, or coverage that are health care related.**
- Oklahoma – establishes a Tobacco Settlement Endowment Trust Fund, funded by 50% of state settlement payments beginning July 1, 2002, phasing up to 75% of state settlement payments in 2007, and thereafter. The fund would be used to support tobacco prevention and cessation programs, health care, education, other children's services and programs for seniors.**

- **Oregon – two separate initiatives, one creates a tobacco settlement trust fund, the earnings from which would fund health care for low-income individuals; the other established the Health Security Fund and all expenditures from the fund would be limited to “health programs,” including transportation of the elderly and disabled, housing for the disabled and for low-income families and other programs established as eligible by state law.**
- **Utah – amends the constitution to establish a permanent state trust fund consisting of the state’s tobacco settlement funds, the assets of which will be invested by the state treasurer. Income from the trust fund will be put into the state general fund and be subject to appropriations.**

WHAT ARE THE NEXT STEPS FOR STATES?

State Legislative/Administrative Initiatives

States will continue to make adjustment in their tobacco settlement spending plans. The tobacco settlement also leaves plenty of room for additional state legislative initiatives regarding youth access. After a state has attained state specific finality, tobacco companies are prohibited from opposing certain kinds of state or local legislation, laws or administrative that are intended to limit youth access to and consumption of tobacco products. The settlement establishes eight areas of state legislation/regulation that the industry is prohibited from

lobbying against. The restrictions apply to legislation, laws or administrative rules that:

- **Limit youth access to vending machines.**
- **Include cigars within the definition of tobacco products.**
- **Enhance enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to youth.**
- **Encourage or support the use of technology to increase the effectiveness of age-of-purchase laws (e.g. the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks).**
- **Limit promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.**
- **Enforce access restrictions through penalties on youth for possession or use.**
- **Limit tobacco product advertising in or on school facilities, or the wearing of tobacco logo merchandise in or on school property.**
- **Limit non-tobacco products that are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes etc.**

There is a provision in the MSA that prohibits the manufacture of cigarettes in packages of less than 20 and prohibits the sale of cigarettes in packages of less than 20. These provisions sunset December 31, 2001, unless a state enacts legislation prohibiting these practices. I am certain that many state legislatures will consider this and other youth access issues during the 2001 legislative session.

Supporting the Passage of Federal Legislation on Gray Market Cigarettes

“Gray Market” cigarettes are product that is manufactured for foreign sale, but is diverted back to the United States by third parties for domestic sale. These cigarettes are typically sold at below market prices, making them more attractive to youth. In addition, every pack of gray market cigarettes sold, displaces the sale of a domestic pack, lowering payments to the states through the MSA, since payments are based on the sale of and the market share of domestic product. While 44 states have enacted legislation in this area, state legislation cannot fully resolve the problem.

The Balanced Budget Act of 1997 (BBA '97) made the reimportation of tobacco products produced domestically for foreign sale (Export Labeled) illegal for everyone except product manufacturers.

Unfortunately, BBA '97 had no similar provisions for product manufactured overseas for sale overseas (Foreign Source) that is diverted to the United States market. As a result, Foreign Source product is becoming the dominant source of gray market cigarettes.

I would like to take this opportunity to urge your support of legislation recently approved by the Senate Finance Committee that includes provisions that would address the growing problem of gray market cigarettes by:

- **Banning Foreign Source tobacco products not intended for sale or consumption in the United States;**
- **Limiting the reimportation of previously-exported tobacco products to only the original manufacturer, its authorized agent or authorized warehouse;**
- **Applying criminal penalties for the diversion-before-export of tobacco products manufactured domestically for export only;**
- **Making all export labeled tobacco products contraband by a date certain to eliminate the enforcement confusion created by the legal status of export labeled product that was “removed” prior to January 1, 2000;**
- **Require the forfeiture and destruction of all gray and black market product seized; and**
- **Clarify the law regarding purchases of products for personal use at duty-free stores of a limited quantity of cigarettes.**

I thank you for this opportunity to discuss tobacco settlement issues with you and would be happy to answer questions.